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TEDE-00 INR-00 IO-00 LAB-01 MOFM-00 MOF-00 VCIE-00
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FM AMEMBASSY SKOPJE
TO SECSTATE WASHDC 8149
INFO NSC WASHDC
DEPT OF TREASURY WASHDC
EUROPEAN POLITICAL COLLECTIVE 0507

UNCLAS SKOPJE 000153

DEPT PLS PASS TO USAID and EUR/SCE FOR ANNA STINCHCOMB
TREASURY FOR WLINDQUIST
NSC PLS PASS TO JEFF HOVENIER AND KATHERINE HELGERSON

E.O. 12958: N/A
TAGS: EFIN ECON PREL EAID MK
SUBJECT: MACEDONIA: MIXED SIGNALS AS BUDGET REALITIES MEET ELECTION POLITICS

SENSITIVE BUT UNCLASSIFIED - PLEASE PROTECT ACCORDINGLY

Summary

¶1. (SBU) The Macedonian Government seems to be underestimating the likely effects of the global economic crisis on the Macedonian economy, especially on the domestic currency. Not only has revenue collection in the first two months of 2009 fallen short of the projections on which the state budget was based, but revenues are down from the same period in 2008. Demonstrating a lack of coordination on monetary policy measures, the GoM has begun borrowing from the domestic market, offering surprisingly high interest rates. At the same time, foreign currency reserves continue to be depleted, adding to concerns for the stability of the domestic currency. End summary.

Economic Crisis Damaging the Real Sector

¶2. (SBU) Macedonia's real sector economy has begun to feel the effects of the global downturn. Industrial output in January-February 2009 fell 14 percent compared to the same period of last year. Additionally, the trade deficit grew, with exports dropping by 44 percent. Several large exporters in the metal industry closed plants and placed workers on forced leave to help deal with the drop in demand. The GoM, however, has so far ignored the damage to Macedonia's most important export sectors. Significantly, the GoM in advance of the second round elections April 5 held firm to its original projection of 5.5 percent GDP growth, upon which the 2009 state budget was created.

Revenue Projections Not Met, but Not Changing

¶3. (U) As a result of the country's reduced economic activity, revenues to the state budget have been insufficient to finance the GoM's populist spending projects. In fact, the GoM missed its revenue collection targets for January and February by 17 percent, and Finance Minister Slaveski announced that actual collection was down three percent from the same period last year. Still, the state budget has not been adjusted to account for the reality of the country's revenues. Instead, the GoM announced plans to spend more than USD 10 billion on infrastructure and energy projects in the period 2009-2017, as Prime Minister Gruevski focused on campaigning for the local and presidential elections. Unheeded, officials from international financial institutions such as IMF have warned the GoM of the widening budget deficit and recommended a prompt budget

rebalancing with more realistic targets. These calls, however, appear to have been lost in the cacophony of the election campaign.

GoM Reaches to Unsustainable Financing

¶4. (U) In order to finance the budget deficit, the GoM borrowed an additional USD 90 million from the domestic market in March by selling 28-day treasury bills at rates significantly higher than the interest rate on the Central Bank bills. On March 25, IMF Resident Representative Bert Van Selm told us that this short term borrowing did not provide sustainable financing, although it draws denar liquidity out of the banking sector. Furthermore, Van Selm told us that Slaveski had told him that the GoM could use the resources of the National Bank of the Republic of Macedonia (NBRM), or Central Bank, to finance the budget as needed. Van Selm expressed serious concerns about Slaveski's cavalier claim that the GoM wished to use the NBRM for these purposes, which is both illegal and contrary to EU regulations with which the GoM has declared it seeks to harmonize.

Central Bank Increases its Bills Rate

¶5. (U) Facing a serious drop in the level of Central Bank bills, the NBRM on March 27 increased the interest rate on Central Bank bills from seven to nine percent, sending a signal that banks should further tighten lending. Most banks announced they will follow the Central Bank's signal and would increase their interest rates, leading to more expensive loans to businesses and households.

Devaluation Expectations Pressure the Exchange Rate
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¶6. (U) Even as pressures for devaluation of the exchange rate are increasing, the GoM has been preoccupied with elections and remained on the economic sidelines. In particular, the GoM sent confusing budget messages by offering high interest rates on government paper. That action was not coordinated with the monetary authorities and heated up devaluation expectations, which officials at the NBRM complained had made their job even harder. In the first three weeks of March, the NBRM had to sell an additional USD 110 million of reserves to defend the peg of the denar against the euro.

Comment

¶7. (SBU) Devaluation of the denar would be costly and have long term negative effects to the economy. The NBRM knows this and is desperately trying to avoid it. However, many IFIs and economic experts in the country think that the GoM does not fully understand the possible consequences. Rumors circulate that Gruevski has a political game in mind and is setting up scenario for replacing NBRM Governor Goshev after the presidential elections. With Gjorge Ivanov's election victory, this becomes a real possibility: NBRM's Governor is nominated by the President, with Parliament's concurrence. Gruevski and his government have long been at odds with the Goshev's conservative approach. The PM also has emphasized publicly that the NBRM is responsible for maintaining the denar's exchange rate. Current economic difficulties may well provide the pretext needed to replace the Governor and to justify an eventual devaluation. End comment.

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